Another Year of Recession and War Drive Down Taxable Sales

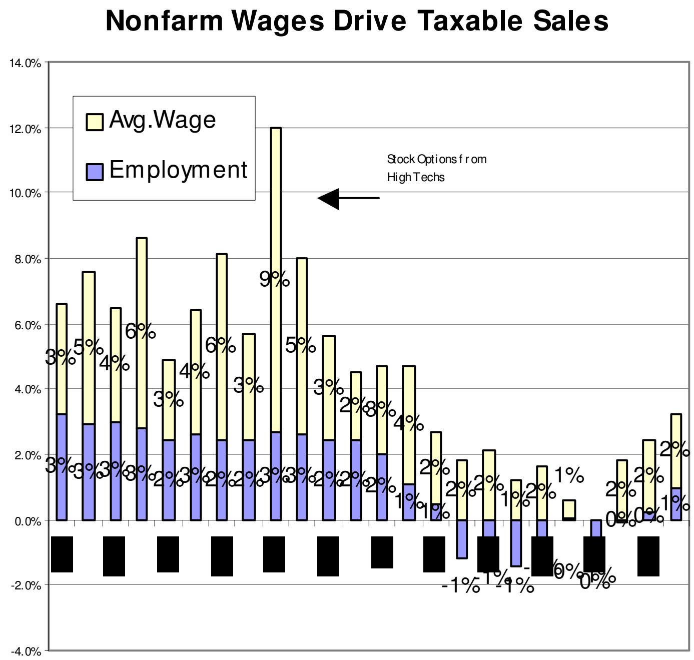
Since the 9/11 attacks and the 2001 U.S. recession taxable sales have barely improved. Growth rates have been 0.3 percent in 2002 and 0.3 percent in 2003, the slowest gains since 1987. Excepting a growth pause in 1997, taxable sales growth ranged from 5 percent to 12 percent between 1988 and 2000 (Table 1).

The war with Iraq disturbed consumer and business investment in the first half of 2003. Taxable sales fell 4.1 percent in the first quarter, followed by a 1.6 percent growth in the second quarter. The second half proved to be only a bit more improved: third quarter sales rose 2.4 percent and fourth quarter taxable sales increased 2 percent over the same quarter in 2002.

The leading driver for taxable sales is Nonfarm Wages and Salaries, which approximates how much money Utahns have to spend. This is a quarterly series produced by the Department of Workforce Services. Figure 1 plots the two components of Wages and Salaries – employment and average wage growth. Improvement in the second half of 2003 for both employment and average wages is consistent with improving taxable sales.

Taxable Retail Trade sales picked up following a zero growth first quarter to 3 percent in the second quarter, 3.9 percent in the third and fourth quarters. The overall growth rate of 2.5 percent was the lowest annual growth rate since 1987 (and very close to 2001's 2.7 percent). This verifies how important outside economic shocks are to consumer behavior. **Still 2.5 percent growth rate for 2003 was better than the 1.7 percent growth in Nonfarm Wages and Salaries, implying that consumers may have spent savings, or more likely borrowed the difference.**

Figure 1.



In the U.S., Personal Consumption Expenditure (current dollar) growth of 4.9 percent in 2002 was almost double the increase in Utah Retail Trade sales.

Nondurable Retail goods sales in Utah rose only 1.9 percent in 2002. The first quarter decline of 3 percent was followed by respective growths of 2 percent and 4 percents in the second through fourth quarters.

For the third year in a row a few big-box discounters earning double-digit gains pulled sales from smaller Food and Miscellaneous Shopping Goods stores. General Merchandise stores made another $200 million plus grab and grew 6 percent in 2003 (Table 2). This was a much smaller percentage gain in past years – 11 percent in 2001 and 16 percent in 2002. Meanwhile, Food store sales fell 4.7 percent in 2003, less bleeding than in 2002 when sales fell 9 percent (which followed the 3 percent drop in 2001). Apparel, Miscellaneous Shopping Goods and Eating and Drinking stores saw increases in the 3 percent range during 2003. Given the fact that clothing prices dropped 2.5 percent in 2003, the 2.6 percent gain in Apparel sales equates to a 5 percent real dollar-gain in apparel consumption.

Retail Durable sales rose 3.5 percent in 2003, slightly less than the 3.8 percent gain in 2002. Given only a 1.7 percent increase in Nonfarm Wages and Salaries in Utah during 2003, the 3.5 percent growth rate in durable goods sales was very strong. In addition, when we consider that prices for motor vehicles and furniture were actually falling in 2003, then Utah consumers even got a better deal. For example, Motor Vehicle Dealer sales rose only 2.1 percent in 2003, but when we consider that the prices fell 2.8 percent then real consumption of Motor Vehicle Dealer sales rose almost 5 percent. Similarly, Furniture store sales rose 1.9 percent. But the Furniture and Household Equipment price deflator, a measure of furniture prices in the U.S., fell 5.9 percent. This implies that Utah personal consumption for furniture, household appliances, electronics, computers, records and musical instruments grew nearly 8 percent in real dollars. But prices for residential construction rose 4 percent in 2003, so the 8.6 percent current dollar gain translates to a 4.6 percent real dollar increase for Utah consumers in 2003.

Building and Garden store sales increased by double-digits during the second half of 2003, with 11 percent and 13 percent respective gains in the third and fourth quarters. This was partially in response to 32 percent and 22 percent respective gains in the same quarters for Utah residential building permit values.

On a quarterly basis, Motor Vehicle Dealer sales made a strong, 7 percent gain only in the second quarter, perhaps when zero-percent financing was in place. Motor Vehicle Dealer sales fell 1 percent in the first quarter and rose only 1 percent in the third and fourth quarters. Unit automobile sales rose only 0.3 percent in 2003, moderating after a 10 percent jump in 2002. This appears to be consistent with the 1.5 percent gain in New & Used Car Dealer sales volume for 2003 (Section III).

Double-digit percentage gains occurred for Recreational Trailer and Motorcycle (ATV and Snowmobile) Dealer sales in 2003, both growing 13 percent, on top of similar, strong gains in 2002 (Section III). Boat Dealer sales fell 19 percent, possibly in response to Utah's shrinking reservoirs and lakes.

Business Investment purchases, which grew 10 percent or more in six of the ten years during the 1990s and rose 6.8 in 2000, the Y2K year (Table 1), then slowed down to a 2.4 percent growth rate in 2001. Under the weight of overcapacity, slack demand, and the threat of a Middle East war, **Business Investment** fell 6.4 percent in 2002. After a near 6 percent drop during the Iraq War-first quarter, **Business Investment** purchases began to show signs of leveling off. Second quarter purchases fell only 0.5 percent, third quarter saw a gain of 1.1 percent and fourth quarter purchases fell 1.4 percent. Five of the nine sectors declined in 2003, in contrast to seven sector declines in 2002 (Table 2):

1) Mining purchases (off 10%)
2) Construction (off 3%)
3) Transportation (off 7%)
4) Electric and Gas (off 9%) and
5) Wholesale-Nondurables (off 4%).

It seems improbable that that Construction purchases would be down 3 percent, while residential permit values climbed 22 percent and nonresidential permit values rose 13 percent in 2003. Nevertheless, General Building Contractors reported a 33 percent drop in taxable purchases and Heavy Construction purchases fell 4 percent in 2003 (Section III). It is possible that recent court rulings on attachments to real property for carpet dealers may be affecting taxable purchases here.

The 9 percent drop in Electric and Gas sales and purchases was partially due to the large pipeline purchase in 2002 that amounted to $80 million.

Flat to near 2 percent gains were reported by Manufacturers, Communications companies and Wholesale-Durable goods stores. Since each of these sectors reported purchases between $1.4 and $2.5 billion, this perhaps is more significant than the declining sectors mentioned above.

The investment-led recession, the 9/11 attack and the wars in Afghanistan and Iraq continued to depress overall taxable **Services,** which have fallen three years in a row: -1% in 2001, -2% in 2002 and almost -5% in 2003. In 2003, seven out of eight sectors' taxable services declined relative to 2002. The two largest sectors, both running close to $1 billion in sales and services per year, Business Services and Auto Rentals and Repair saw 3 percent declines in 2003. But by the fourth quarter Business Services reported a 2.5 percent gain.

Hotel and Lodging sales fell 11 percent in 2003, but this was compared to the 12.5 percent gain made in 2002 due to the Winter Olympics. If we adjust out that event, Hotel sales in 2003 would have been pretty flat. In fact, the $599.5 million in 2003 Hotel and Lodging sales was very close to the $599.1 million recorded in 2001.

Finance and Real Estate sales and leases were off almost 15 percent, perhaps due to unpopularity of auto leasing when zero-rate financing is available. Amusement and Recreation sales were flat (-0.3%), but this masked a 9 percent gain at Utah's ski resorts (Section III). Motion Picture sales were off 1 percent, but 2002 sales had jumped 18 percent.

Fourth Quarter Taxable Sales Up 2%

Final taxable sales rose 2 percent during the fourth quarter of 2003 to $8.48 billion (for current period sales). Due to the boom in residential construction, taxable sales were expected to increase between 4 and 6 percent (Table 1). Excepting **Retail Trade** sales, the other two remaining major sectors, **Business Investment** and **Services** declined in the fourth quarter relative to the same quarter in 2002. The third and fourth quarter 2 percent gains followed seven quarters of sluggish sales, which changed between –4 percent and +1.5 percent since 9/11.

Twenty of the 30 sectors reported positive growth in the fourth quarter of 2003, compared to only 11 in the second quarter. **Retail Trade** sales, the largest major sector with nearly 54 percent of taxable sales, reported a fairly strong 3.9 percent increase, below our 4.8 percent forecast made in November 2002 (Table 1), and below U.S. retail trade growth of 4.9 percent in the fourth quarter of 2003. Strong sales growth was reported in Retail-Building and Garden stores. Modest gains were seen in General Merchandise, Apparel, Eating and Drinking, and Miscellaneous Shopping Goods stores in the fourth quarter of 2003. Food store sales, however, fell 3 percent.

Only four of the nine **Business Investment** sectors saw declining purchases and sales in the fourth quarter of 2003 leaving it nearly 1 percent below purchases in the fourth quarter of 2002. This compares to seven out of nine declining sectors between the third quarter of 2002 and the second quarter of 2003. Communications rebounded from a 1 percent decline in the fourth quarter of 2002 to an 11 percent gain in the fourth quarter of 2003. Transportation sector purchases bounced back 39 percent following a 42 percent tanking in 2002's fourth quarter. Despite strong construction, Manufacturers and Construction Contractors reported declining purchases. Electric and Gas companies reported a 21 percent decline, but last year's 37 percent gain included a one-time $120 million natural gas line purchase. Importantly, Wholesale-Durable Goods final sales rose 5 percent following a 6 percent drop in the fourth quarter of 2002.

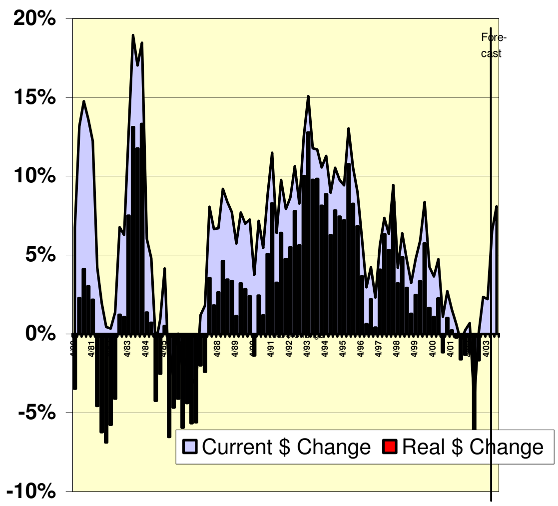
TABLE 1.	UTAH FORE-CAST* 2003q4	UTAH 2003q4 Final	U.S. ACTUAL 2003q4
RETAIL TRADE	4.8	3.9	4.9
BUSINESS INVEST.	0.3	-1.4	9.7
SERVICES	7.6	-0.6	4.5
TOTAL	4.0	2.0	n\a

** Forecast made in November 2002*
U.S. sources: Survey of Current Business, BEA, Dept. of Commerce, January 2004, and for Retail Trade: www.census.gov/mrts/www/current.htm

Half of the eight **Service** sector's sales were in decline during the fourth quarter of 2003. Business Services, which typically follow the lead of **Business Investment**, saw their sales level off and finally rise in the fourth quarter by 2.5 percent. The largest sector, Auto Rentals and Repair, reported sales 3 percent below those in 2002. Hotel sales were up 6 percent. The Finance and Real Estate sector saw its sales and automobile and other leases plummet 16 percent in the fourth quarter.

After accounting for consumer **deflation** of 1.4 percent, **total real dollar taxable sales and purchases** (including prior-period payments, adjustments and refunds) **rose 0.8 percent in the fourth quarter of 2003. This was the second positive real gain since the fourth quarter of 2001.** Between the third quarter of 2001 (one quarter after the U.S. recession commenced) and the second quarter of 2003 taxable sales in Utah had worsened (Figure 1).

Figure 1. Percent Change in Utah Taxable Sales

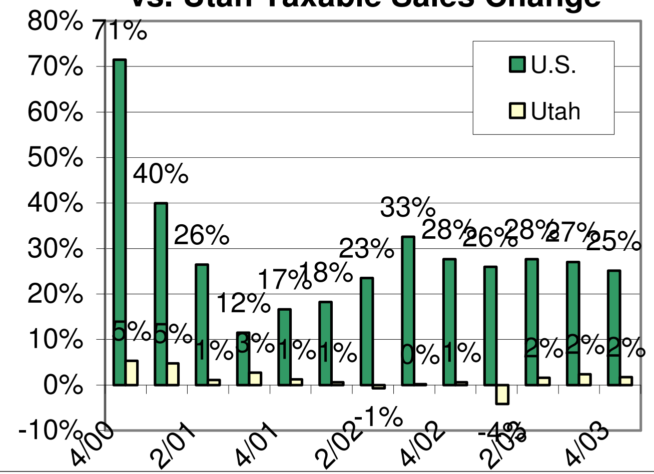


In summary, it appears that Utah's consumers increased personal consumption during the fourth quarter, but again not as much the rest of the nation. It also appears that Utah's business sector continues to forego investment compared to the nation as a whole, but the declines appear to be leveling out. The positive purchases reported in Business Services and Wholesale-Durable Goods dealers were encouraging. But based on improvements to national and Utah economic indicators in the fourth quarter (Table 3), one would have expected a much better report.

E-Commerce Retail Sales Jump Again

According to the U.S. Department of Commerce, U. S. retail E-commerce rose 25 percent to $17.2 billion in the fourth quarter. Assuming Utah equals 0.63% of that amount, Utah E-commerce retail sales would be $108 million for the quarter (and if taxable would amount to $5.1 million in foregone revenue at the state's 4.75% rate). Figure 2 compares the recent growth rates in Utah taxable sales with the U.S. growth rates in E-commerce over the past ten quarters.

Figure 2. U.S. Retail E-commerce Sales Change vs. Utah Taxable Sales Change



Regional Growth

Fourth quarter taxable sales growth along the Wasatch Front (including the Mountainlands Region, Table 4) rose 2 percent, ranging from -24 percent decline in Tooele County to +12 percent growth in Morgan County compared to the same period in 2003:

1) Salt Lake County – up 2.5 percent,

2) Utah County – up 2.9 percent,
3) Davis County – up 2 percent,
4) Weber County – up 3.2 percent.

Nineteen of the 29 counties reported taxable sales gains in the fourth quarter. This compares favorably with the 10 counties with sales gains in the first quarter of 2003.

At first glance, direct sales for Utah's 55 major cities rose 10.6 percent, much higher than the 2 percent state growth during the fourth quarter of 2003. But after adjustments are made to account for the increase in direct sales base, a "comparable" percentage change for the 54 cities is was 4.7 percent (Table 5), still higher than the overall statewide growth rate.[1]

Table 3. Taxable Sales Economic Drivers	**Fourth quarter 2003 Growth Over Prior Year**
Utah non-farm wages, preliminary	**1.7%**
U.S. Consumer Sentiment Index	**+8.2%**
Inflation - U.S. Personal Consumption Deflator	**1.4 %**
Utah Residential Construction Value	**22 %**
U.S. Investment in Equipment & Software	**9.7 %**
Utah New Car and Truck sales	**9.6 %**
SLC Airport Total Passengers	**-3.9%**

Sources: Utah Department of Workforce Services; Bureau of Economic Analysis, Valley Research; U.S. Department of Commerce; University o f Utah, Bureau of Economic and Business Research; Economy.com; Salt Lake City Intl. Airport.

1 The adjustment is necessary to account for a Tax Commission shift of public utility sales from indirect sales (by county) to a more direct sales basis (by city). This change has been occurring since the first quarter of 2004 and should be carefully watched by analysts. In addition, it is important to note that this adjustment increased from 3 percent of taxable sales in the second quarter of 2003 to 5.4 percent in the fourth quarter, suggesting that more utilities are switching over. A good example is Salt Lake City, where "Revised and Final" direct sales rose 10.1 percent; but $66 million of the increase in direct sales occurred in the Communication and Electric and Gas Sectors, where the Tax Commission moved utility accounts from indirect county basis to direct city basis commencing in the first quarter of 2003. So backing out the $66 million, we find that "Comparable" sales (which provides a more accurate reflection of city sales growth) were up by 3.2 percent in the fourth quarter of 2003.